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Kruttschnitt, Julius

Proposed increases in freight rates in eastern...

[New York]

[1917]

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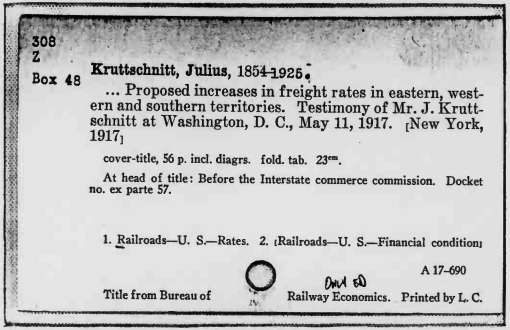

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Kruttschnitt, Julius, 1854-1925.

... Proposed increases in freight rates in eastern, western and southern territories. Testimony of Mr. J. Kruttschnitt at Washington, D. C., May 11, 1917. [New York, 1917]

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BEFORE THE

INTERSTATE COMMERCE COMMISSION

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DOCKET NO. *EX PARTE* 57

In re: Proposed Increases in Freight Rates in Eastern, Western and Southern Territories

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Testimony of Mr. J. Kruttschnitt at Washington, D. C., May 11, 1917

BEFORE THE

Interstate Commerce Commission.

IN RE: PROPOSED INCREASES IN FREIGHT RATES IN EASTERN, WESTERN AND SOUTHERN TERRITORIES.	Docket No. *Ex parte 57.*

JULIUS KRUTTSCHNITT was called as a witness, and being first duly sworn, testified as follows:

DIRECT-EXAMINATION.

Mr. Donnelly: You are the chairman of the executive committee of the Southern Pacific Company?

Mr. Kruttschnitt: I am.

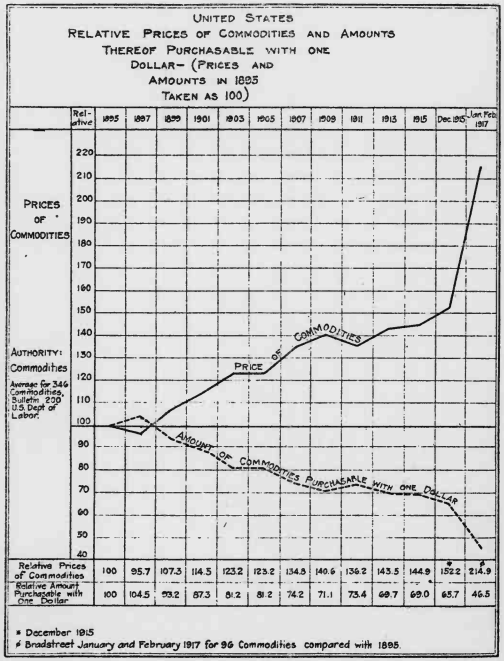
Mr. Donnelly: Have you prepared a statement dealing with the questions involved in this proceeding?

Mr. Kruttschnitt: I have.

Mr. Donnelly: Will you please read that statement to the Commission.

Mr. Kruttschnitt: Mr. Chairman and gentlemen of the Commission, neither the actual condition nor the unmistakable tendency of railroad earnings has been good for many years. The last twenty years have been a period of constantly increasing prices of all commodities except transportation, the price of which to the public has decreased. The increase in commodity prices and

CHART NO. 1.


UNITED STATES
RELATIVE PRICES OF COMMODITIES AND AMOUNTS THEREOF PURCHASABLE WITH ONE DOLLAR- (PRICES AND AMOUNTS IN 1885 TAKEN AS 100)
PRICES OF COMMODITIES
AUTHORITY: Commodities Average for 346 Commodities, Bulletin 200 U.S. Dept of Labor.
PRICE OF COMMODITIES
AMOUNT OF COMMODITIES PURCHASABLE WITH ONE DOLLAR
Relative | 1885 | 1887 | 1899 | 1901 | 1903 | 1905 | 1907 | 1909 | 1911 | 1913 | 1915 | Dec 1915 | Jan Feb 1917
220
210
200
190
180
170
160
150
140
130
120
110
100
90
80
70
60
50
40
Relative Prices of Commodities | 100 | 95.7 | 107.3 | 114.5 | 123.2 | 123.2 | 134.5 | 140.6 | 136.2 | 143.5 | 144.9 | 152.2 | 214.9
Relative Amount Purchasable with One Dollar | 100 | 104.5 | 93.2 | 87.3 | 81.2 | 81.2 | 74.2 | 71.1 | 73.4 | 69.7 | 69.0 | 65.7 | 46.5
* December 1915
≠ Bradstreet January and February 1917 for 96 Commodities compared with 1885.

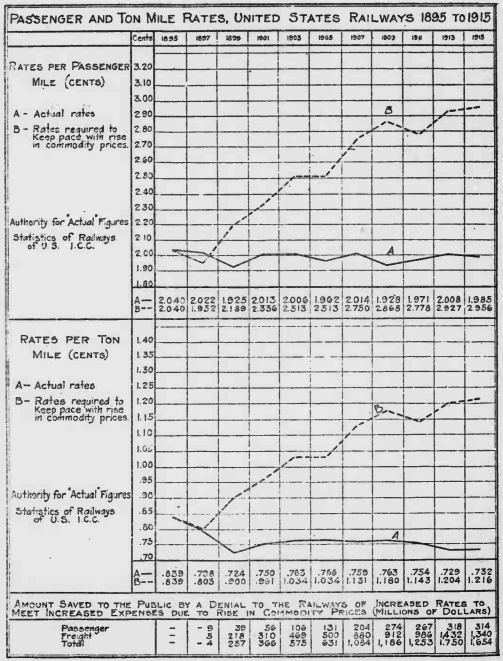
the resulting fall in the purchasing power of the dollar since 1895 are illustrated by chart No. 1, which is filed as a part of my testimony. During the same period transportation rates have decreased, as indicated by chart No. 2, which also shows what present rates of transportation would be, if the prices of transportation had increased in the same proportion that commodity prices have increased. The first chart shows an increase between 1895 and 1915 of 52 per cent. in the average price of 346 commodities, and a total increase between 1895 and the early part of 1917 of 115 per cent. (Bulletin No. 200 of the United States Department of Labor, and Bradstreet's Index Numbers); and a corresponding reduction in the purchasing power of the dollar of 35 per cent., between 1895 and 1915, and of 55 per cent. between 1895 and 1917.

By way of explanation, chart No. 1 shows in the full line above the datum, the 100 line, the price of commodities in the periods indicated by the figures at the top. The authority for those prices is Bulletin No. 200 of the United States Department of Labor, except for December, 1915, and January and February, 1917, the authority for that being Bradstreet's index numbers.

The amount of commodities purchasable for $1, on the dotted line below the datum line, is naturally the reciprocal of the other, or the upper line.

On chart No. 2, the upper half of the chart relates to passenger rates, which are not under discussion, but the lower half of the chart relates to freight rates. The rates per ton mile are shown in the full line marked "A." The rates required to keep pace with the rise in commodity prices are shown by the dotted line marked "B." The

CHART NO 2.


PASSENGER AND TON MILE RATES, UNITED STATES RAILWAYS 1895 TO 1915
Cents
RATES PER PASSENGER MILE (CENTS)
A - Actual rates
B - Rates required to keep pace with rise in commodity prices.
Authority for "Actual" Figures Statistics of Railways of U.S. I.C.C.
RATES PER TON MILE (CENTS)
A- Actual rates
B- Rates required to keep pace with rise in commodity prices.
Authority for "Actual" Figures Statistics of Railways of U.S. I.C.C.
AMOUNT SAVED TO THE PUBLIC BY A DENIAL TO THE RAILWAYS OF INCREASED RATES TO MEET INCREASED EXPENSES DUE TO RISE IN COMMODITY PRICES (MILLIONS OF DOLLARS)
Passenger
Freight
Total

Cents	1895	1897	1899	1901	1903	1905	1907	1909	1911	1913	1915
A—	2.040	2.022	1.925	2.013	2.006	1.962	2.014	1.928	1.971	2.008	1.985
B--	2.040	1.952	2.189	2.336	2.513	2.513	2.750	2.865	2.778	2.927	2.956

	1895	1897	1899	1901	1903	1905	1907	1909	1911	1913	1915
A—	.839	.728	.724	.750	.763	.766	.759	.763	.754	.729	.732
B--	.839	.803	.900	.861	1.034	1.034	1.131	1.180	1.143	1.204	1.216

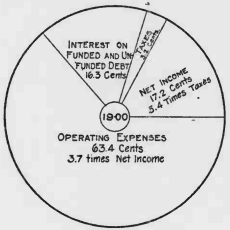
	1895	1897	1899	1901	1903	1905	1907	1909	1911	1913	1915
Passenger	—	- 9	30	56	108	131	204	274	267	318	314
Freight	—	5	215	310	468	500	880	912	986	1432	1340
Total	—	- 4	257	366	575	631	1,084	1,186	1,253	1750	1654

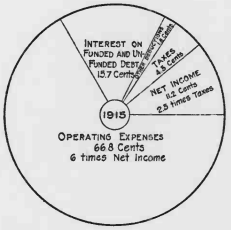
authority for the actual figures is the Statistics of Railways for the United States, published by the Interstate Commerce Commission.

It will be observed that while there have been temporary fluctuations, the upward tendency of prices has been continuous and has scarcely been arrested at any one time for a period of twelve months. The second chart shows that between 1895 and 1915 the average revenue per ton mile has decreased from 8.39 mills to 7.32 mills. An increase in the price of transportation to correspond with the rise in commodity prices during the same twenty-year period would have resulted in an average ton-mile revenue in 1915 of 12.16 mills. Of course, it does not follow that the price of transportation should increase in the same proportion that the prices of other commodities increase, but the relation between the two, in these periods, is certainly an interesting commentary upon the railroad operations of the past twenty years. Although by no means conclusive, it should certainly be a matter of interest to the public at large to know, in connection with application for increased freight rates at the time of the most unprecedented increase in commodity prices, that its transportation bill for the year 1915, the last year for which official figures of ton mile earnings are available, is $1,340,000,000 less for the transportation of freight and $314,000,000 less for the transportation of passengers than it would have been if the price of transportation had kept pace with the prices of commodities generally for the previous twenty years. These calculations are based on the commodity prices of 1915, which, as indicated on the charts, were the result of a steady but relatively gradual increase, and the

CHART NO. 3.

ALL RAILWAYS OF UNITED STATES
DISPOSITION OF EACH DOLLAR OF GROSS RECEIPTS IN 1900 AND 1915


INTEREST ON FUNDED AND UNFUNDED DEBT 16.3 Cents
TAXES 1.9 Cents
NET INCOME 17.2 Cents 5.4 Times Taxes
1900
OPERATING EXPENSES 63.4 Cents 3.7 times Net Income


INTEREST ON FUNDED AND UNFUNDED DEBT 15.7 Cents
RENTALS 1.4 Cents
TAXES 4.8 Cents
NET INCOME 11.2 Cents 2.3 Times Taxes
1915
OPERATING EXPENSES 66.8 Cents 6 times Net Income

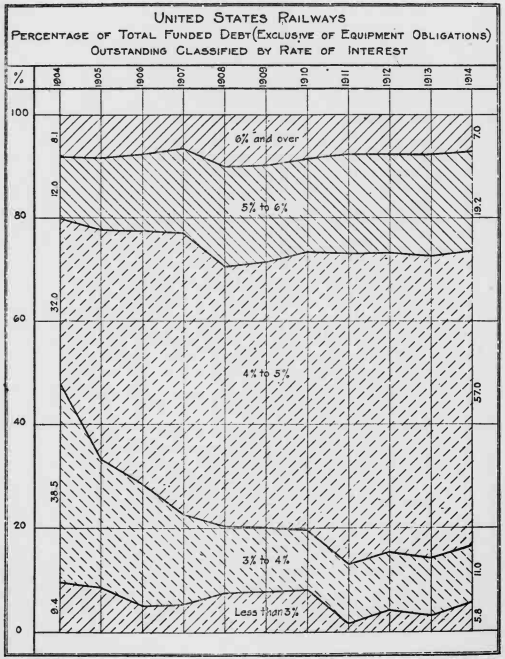
Authority:-I.C.C. Statistics of Railways of U.S.

figures stated do not take into account the rise in prices since 1915, a rise in itself equal to that of the entire preceding twenty years. The combined effect of falling rates of transportation and falling purchasing power of the dollar has been to greatly reduce the contribution to net earnings and return on investment yielded out of each dollar paid by the public for transportation service; in other words, the railroad must receive its pay in a debased dollar worth but 45 cents.

Constantly increasing commodity prices have increased the cost of living for the railroads, just as they have done for individuals. They are reflected in increased wages, made necessary to enable railroad employes to buy that which they individually consume, and an increased cost of all materials and supplies which the railroads themselves consume. The combined effect of these two causes is shown by chart No. 3, showing the disposition of each dollar of gross receipts in 1900 and 1915. It also discloses another important fact, namely, the increase in charges other than operating expenses, such as taxes and other deductions from income, as a result of which the net income, after paying operating expenses, interest, taxes and other charges, was reduced from 17.2 cents out of each dollar to 11.2 cents, while the total contribution to capital made up of interest on funded debt and net income, after the payment of all charges, was reduced from 33.5 cents out of each dollar collected, to 26.9 cents.

In 1900 the operating expenses were 3.7 times the net income, in 1915 six times the net income. During the same period the service performed increased in round figures from 140,000,000,000

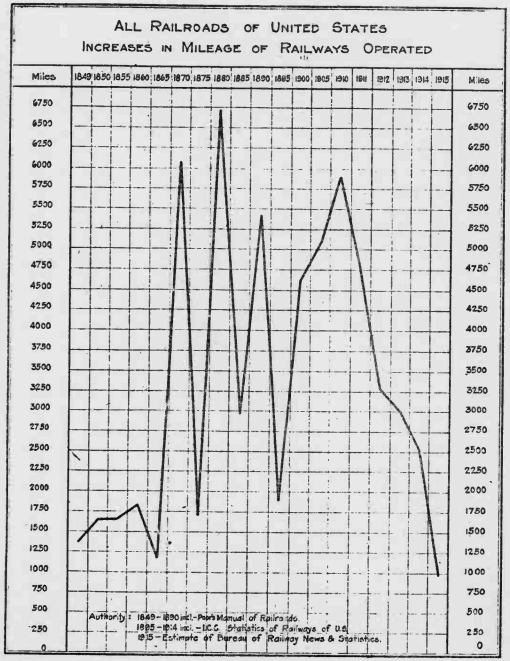
CHART NO. 4.



ton miles to 340,000,000,000 ton miles, or 143 per cent.

As already indicated, this added tonnage was carried at a constantly declining average rate, and of the added dollars accruing to the transportation companies in gross, the owners of those properties have received a constantly diminishing share, while all others have received a constantly increasing share. These increasing costs and diminishing returns per dollar received have been offset only by constantly improved transportation methods, made possible in a large measure by capital expenditures. From 1895 to 1915 the cost per train mile increased from 92 cents to 172 cents, a rise of 93 per cent. Universal bankruptcy was avoided by the carriers only by heavy capital expenditures to reduce grades, eliminate curvature, and to purchase heavier locomotives and cars, all incurred for the purpose of increasing efficiency by hauling more tons per locomotive, which increased between 1895 and 1915 from 190 to 472 tons, or 148 per cent. Costs per ton mile in these two years can be estimated by dividing the train cost by tons per train. Such a computation taken in connection with the average revenue per ton mile shows that, while the average rate decreased from 8.4 mills to 7.3 mills, the average cost per ton mile was reduced almost as much, resulting in net earnings per ton mile in the second period of 3.5 mills as against 3.6 mills in the first period, a feat highly creditable to American railway management in face of rising costs and falling rates. To accomplish this, however, and to make necessary additions and improvements to keep pace with the constantly growing commerce of our country, have required con-

CHART NO. 6.



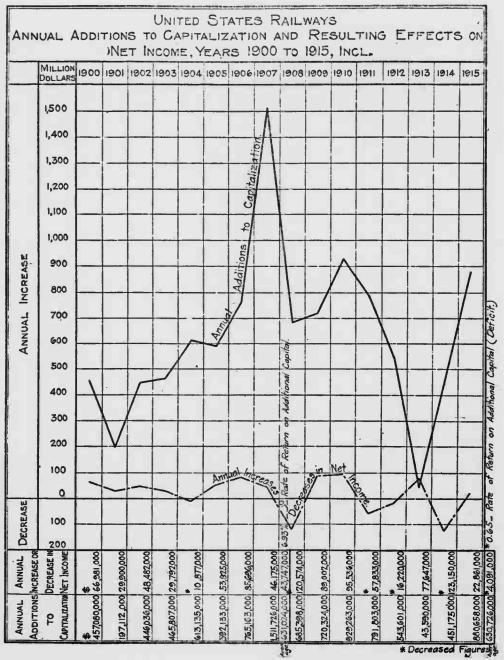
tinually increasing capital expenditure. The funds necessary for this purpose are available through two sources only—surplus income from transportation operations, or the sale of additional capital securities.

Provision for new capital by sale of stock has, within the past twenty years, been impossible in the majority of cases. To what extent funds might have been obtained by taking in new partners or stockholders on a higher level of rates and greater net return is entirely problematical. The fact is that the inability to sell stock has made it necessary to provide additional capital by sale of bonds, with the result that the proportion of bonded debt to capital stock has been constantly increased, with an accompanying decrease in the credit of the borrowing companies. In 1890 the funded debt was but 50 per cent. of the total capital obligations of the carriers. In 1916 it had increased to 65 per cent. of the total. The result is that the credit of the American railways as a whole is not and has not been good, as indicated by the increased rates of interest which they have to pay and the estimation in which the securities are held by the public as contrasted with the rates of interest at which others can borrow (see Chart No. 4, page 8).

Chart No. 6 shows the miles of new railroad built from 1849 to 1915—1,375 miles were built in 1849 and a trifle less than 1,000 miles in 1915. This measures the attractiveness to the public of railroad investments.

Chart No. 7 shows the annual additions to the capitalization of the United States railroads from 1900 to 1915, both inclusive. For the eight years 1900 to 1907, both inclusive, the total amount of

CHART NO. 7.



new capital was $5,048,000,000, an average of $631,024,000 per annum. The average annual return on this additional capital over the return in 1900 was $43,747,000, or 6.39 per cent. For the next eight years, from 1908 to 1915, both inclusive, $5,046,000,000 of additional capital was invested in the railroads, or $630,726,000 annually. Notwithstanding the addition of this second large sum to the capitalization of the railroads, there was a reduction, or loss, in the return on capital invested averaging a little over $4,091,000 per annum; that is, a net loss of 0.65 per cent. on the second addition to capital.

Wettling's exhibit, page 5, shows that while the average mileage operated on forty-six systems in the western group has increased 45 per cent., from 1902 to 1916, the investment in road and equipment has increased about 75 per cent; and, during this period, until 1916, the ratio of return on the investment has steadily declined. Dividing the period into groups of four years, the percentage of net income to investment was as follows:

During four years ending 1904—5.12 per cent.
During four years ending 1908—5.55 per cent.
During four years ending 1912—4.81 per cent.
During four years ending 1916—4.68 per cent.

The return on the investment in the last period was the lowest of any despite the inclusion of the year, 1916, when the ratio of return was 5.43 per cent, this ratio having been exceeded, however, in the earlier years. Comparing the averages for the four-year period ending 1916 with the four-year period ending 1904, the investment in road and equipment increased $2,388,000,000, but there was an increase in net operating income of only

$94,000,000; that is to say, new money placed in these properties earned a return of only 3.9 per cent. From this constant downward trend of earnings and upward trend of expenses, it has long been evident that we were approaching the time when increasing costs could not be offset by operating economies, even if the necessary capital could be secured to provide facilities upon which such economies must be predicated; that such a time would come was foreseen by Commissioner Daniels who in his dissenting opinion in the *Five Per Cent case* said:

> "The world-wide phenomenon of rising prices is by this time no novelty. Since 1906 the average rise in the world's price level is estimated by competent statisticians at from 30 to 50 per cent. It has mirrored itself in the rising cost of living; it has evoked, and most properly, advances in wages and salaries; it has coincided with an increase in the nominal rate of interest where part of the interest so-called is but compensation for the anticipated depreciation of the capital sum later to be repaid. This rise in the price level must eventually be reckoned with in railroading. For a time its effects may be masked by adventitious increases in the volume of traffic, but this temporary relief in its very nature is uncertain, and, sooner or later, the difficulty is sure to reappear. For a time it may be circumvented by extraordinary economies, but in its nature it is inexorable. It must be faced, not trifled with."

We do not understand that there was any disagreement on the part of the members of the Com-

SOUTHERN PACIFIC COMPANY AND PROPRIETARY COMPANIES.

OPERATING REVENUES, EXPENSES, RAILWAY OPERATING INCOME, AND TRAFFIC STATISTICS. FISCAL YEARS ENDED JUNE 30, 1910, TO 1916 AND CALENDAR YEARS ENDED DECEMBER 31, 1915, TO 1916.

	FISCAL YEARS ENDED JUNE 30TH.							CALENDAR YEARS ENDED DEC. 31ST.	
	1910	1911	1912	1913	1914	1915	1916	1915	1916
OPERATING REVENUES:									
Freight revenue	77 018 554 26	73 677 292 78	72 648 091 65	80 141 498 84	78 369 414 08	80 020 751 38	98 567 886 39	86 331 289 80	112 460 567 07
Passenger revenue	40 244 855 79	40 814 399 52	40 269 238 03	42 389 837 48	39 294 183 79	36 864 997 50	40 338 316 29	42 057 401 19	37 112 446 60
All other revenue	7 260 495 03	7 419 335 80	7 515 725 96	7 822 356 34	8 950 938 97	12 979 926 21	13 788 025 51	14 079 214 13	13 854 409 35
Total operating revenue	124 523 905 08	121 911 028 10	120 433 055 64	130 353 692 66	126 614 536 84	129 865 675 09	152 694 228 19	142 467 905 12	163 427 423 02
Outside operations	10 498 701 79	10 709 511 41	11 092 114 95	12 421 012 41	11 905 721 72	.....	.....	.....	.....
(A) Total operating income	135 022 606 87	132 620 539 51	131 525 170 59	142 774 705 07	138 520 258 56	.....	.....	.....	.....
OPERATING EXPENSES:									
Maintenance of way and structures	16 098 705 22	15 889 129 83	14 464 204 81	15 589 026 66	16 064 457 14	15 356 355 77	18 367 137 29	16 988 904 33	18 049 584 78
Maintenance of equipment	16 335 985 61	16 178 753 44	17 172 201 18	20 273 963 77	19 958 556 47	19 815 973 36	21 866 636 02	20 838 609 15	23 579 907 07
Traffic	2 481 186 30	2 947 063 58	3 201 366 63	3 115 078 74	2 889 418 58	2 915 009 84	3 131 404 18	3 121 250 24	3 105 898 74
Transportation—Rail line	35 658 045 72	36 524 585 10	38 270 811 05	40 408 953 93	40 936 821 47	38 682 406 46	41 662 521 45	39 588 761 27	45 777 729 62
Transportation—Water line	.....	.....	.....	.....	.....	5 324 346 65	6 365 382 72	5 841 800 41	6 610 559 38
Miscellaneous operations	.....	.....	.....	.....	.....	2 031 856 61	2 438 348 43	2 406 514 55	2 232 869 04
General	3 467 706 51	3 848 675 54	3 397 583 32	3 726 325 53	3 975 034 57	3 955 027 24	3 913 399 45	3 903 207 82	4 146 810 30
Transportation for investment—Cr.	.....	.....	.....	.....	.....	Cr. 327 133 62	Cr. 301 171 31	Cr. 342 510 04	Cr. 414 622 41
Grand total railway operating expenses	74 041 629 36	75 388 207 49	76 506 166 99	83 113 348 63	83 824 288 23	87 753 842 31	97 443 658 23	92 346 537 73	103 088 736 52
Outside operations	9 750 813 57	10 483 554 02	10 838 936 91	10 734 300 58	10 862 200 16	.....	.....	.....	.....
Total expenses	83 792 442 93	85 871 761 51	87 345 103 90	93 847 649 21	94 686 488 39	.....	.....	.....	.....
Uncollectible railway revenues	.....	.....	.....	.....	.....	50 946 14	37 272 95	43 734 85	61 194 54
(B) Total expenses and uncollectible revenues	83 792 442 93	85 871 761 51	87 345 103 90	93 847 649 21	94 686 488 39	87 804 788 45	97 480 931 18	92 390 272 58	103 149 931 06
OTHER ITEMS—NET:									
Net revenue from miscellaneous operations	.....	.....	.....	.....	.....	.....	.....	.....	.....
Hire of equipment (all classes)	448 342 77	250 481 77	642 158 52	600 581 05	Cr. 266 480 60	Cr. 176 256 88	469 214 97	164 612 75	527 669 97
Joint facilities	*See footnote.	*See footnote.	Cr. 95 308 32	Cr. 135 233 54	252 240 60	Cr. 114 635 26	95 458 13	Cr. 129 344 57	43 241 75
Miscellaneous rents	190 934 69	16 621 36	Cr. 196 707 83	260 277 45	Cr. 277 855 31	203 425 86	119 599 05	138 659 84	135 242 68
(C) Total other items, Dr. or Cr.	639 277 46	267 103 13	350 142 37	725 624 96	Cr. 292 095 31	Cr. 87 466 28	684 272 15	173 928 02	706 154 40
(D) Total items (B) and (C)	84 431 720 39	86 138 864 64	87 695 246 27	94 573 274 17	94 394 393 08	87 717 322 17	98 165 203 33	92 564 200 60	103 855 085 46
Net operating revenue (A) less (D)	50 590 886 48	46 481 674 87	43 829 924 32	48 201 430 90	44 125 865 48	42 148 352 92	54 529 024 86	49 903 704 52	59 571 337 56
RAILWAY TAXES (including taxes on miscl. operating property)	4 519 374 01	4 850 347 67	5 621 238 96	5 697 285 83	7 162 624 57	6 371 272 84	7 023 325 97	6 549 185 77	8 389 292 28
Operating income	46 071 512 47	41 631 327 30	38 208 685 36	42 504 145 07	36 963 240 91	35 777 080 08	47 505 698 89	43 354 518 75	51 302 045 28
RENTALS—NET, LEASE OF ROAD	*See footnote.	*See footnote	459 555 78	648 205 90	691 384 99	622 907 75	693 380 02	645 003 10	680 785 76
Net operating income applicable to net cost of road and equipment	46 071 512 47	41 631 327 30	37 749 129 58	41 855 939 17	36 271 855 92	35 154 172 33	46 812 318 87	42 709 515 65	50 621 259 52
NET COST OF ROAD AND EQUIPMENT	796 057 011 31	820 783 065 02	856 770 085 86	882 876 022 39	902 631 959 28	903 718 243 46	939 971 725 25	938 067 048 88	951 830 440 37
AVERAGE MILES OPERATED—SINGLE TRACK	9 752 26	9 895 07	9 970 40	10 310 99	10 421 65	10 554 24	10 955 97	10 964 68	11 095 91
1. Total freight train miles, including 100% mixed	16 727 053	15 766 941	16 075 480	18 074 104	17 529 071	16 474 713	19 752 719	17 724 055	21 685 570
Passenger train miles, including 100% mixed	23 536 963	24 789 618	24 828 141	25 343 726	29 156 460	27 897 269	31 642 348	30 480 054	30 656 305
2. Total freight car miles	553 081 518	530 044 802	522 350 456	568 100 905	572 234 054	542 113 114	651 772 916	582 629 632	721 556 411
Total passenger car miles	150 132 155	160 437 848	164 359 944	166 735 569	162 643 213	153 946 109	176 496 147	175 368 992	164 471 701
3. Revenue passenger miles	1 805 834 993	1 808 133 603	1 787 640 025	1 834 380 082	1 748 983 080	1 662 556 191	1 914 189 495	2 036 235 926	1 643 207 836
Ton Miles—Revenue freight	6 628 685 724	6 189 785 390	6 145 555 486	7 034 174 870	6 987 916 295	6 637 345 295	9 211 615 334	7 508 055 263	10 775 911 596
Ton Miles—Non-revenue freight	1 343 357 084	1 289 419 371	1 185 958 672	1 300 060 903	1 275 848 254	1 006 386 664	1 188 734 522	1 035 370 216	1 230 333 794

*Segregation, rentals—net, lease of road, joint facilities and miscellaneous rents not available for years 1910 and 1911.
Cr. denotes credits.

mission on this point, but that the difference of opinion within the Commission was solely upon the method by which the admitted decline in earnings of the carriers should be arrested.

The opportunity to offset these increasing costs by economies in operation has greatly diminished; in other words, cars and locomotives are about as large as can be constructed within clearance limits. In fact, experience has demonstrated that the percentage of carrying capacity utilized with present 40 and 50-ton box cars is considerably less than was formerly obtained with smaller cars, but the larger cars are justified because of their slightly additional cost and weight, in proportion to the average capacity thereby gained and because of the hope that higher carload minima and, consequently, larger commercial units, might be brought about in the future. Certain it is that to whatever extent the railroads have been able to offset the increased costs of labor and material by better operating methods in the past, it is now impossible for them to offset the abnormal increases in operating costs which confront them. To illustrate: We present a statement showing the operations of the Southern Pacific Company and proprietary companies, by years, from 1910 to 1916, inclusive. This statement strikingly illustrates the fact that in 1916, with the largest gross revenues in the history of the company—31 per cent larger than in 1910—the net income from operation was but 10 per cent larger while ton miles increased 62 per cent, operating expenses 37 per cent, and taxes 83 per cent. During this period of seven years the investment in road and equipment was enlarged by $155,777,429, or nearly one-fifth. From this additional investment, however, we ob-

tained only $4,549,749 additional net operating revenue, or a return upon each dollar of added investment of but 2.9 cents at a time when interest paid on borrowed money averaged 4.6 per cent, as shown on Chart No. 4, which is before you, and this in the year of our greatest prosperity. The results in 1916 therefore, although producing the largest net earnings in the history of the company, themselves showed the effect of increasing costs and diminishing rate of return on the property investment. The added effect of the extraordinary prices of the present is indicated by contrasting what the results of operation in 1916 would have been under them with the results of operation for the full period of the statement. This statement shows that the average operating income return on net cost of road and equipment for the seven-year period ending with the calendar year 1916 was, in round numbers, $40,600,000. If present prices of labor and materials had prevailed during the calendar year 1916, the net operating income applicable would have been reduced from $50,600,000 to $35,400,000, or $5,000,000 less than the average for the period and less than $300,000 in excess of the poorest year in the period; that is, of 1915. During the same seven-year period the capital invested increased from $796,000,000 to $952,000,000, and since 1915 from $909,000,000 to $952,000,000.

As a further illustration, applying the 1917 prices to operations for the calendar year 1916, the net operating income would have been reduced to a figure which would allow only 3.7 per cent interest upon the investment in road and equipment. Comparing this with 1910, there would not only have been no return upon the $156,000,000 of additional investment, but there would have been an

actual decrease of $10,000,000 in the operating income return on such investment.

The application of present abnormal expenses to the operations of the last calendar year of the railroads of the country as a whole would reduce the net results of their operation to a level below that of 1915, and would give them so inadequate a return upon their property investment as to seriously impair their credit. Credit is necessary not only for extension of lines, but for additions and betterments to existing plant.

Chart No. 5 I will pass to the Commission. Through some oversight in my office there was not a sufficient number of prints made. That deficiency will be supplied, however, promptly. You have telegraphed for more, have you not?

(Reproduced on p. 18.)

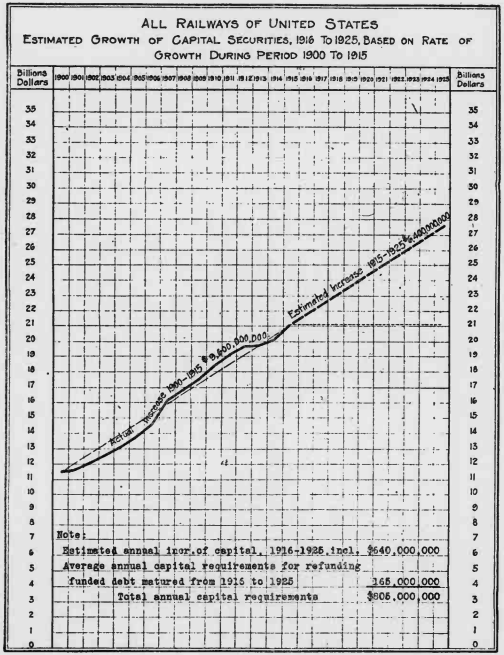
Mr. Wood: Yes.

Mr. Kruttschnitt: Chart No. 5 shows estimated capital requirements of the railroads of the United States, from 1916 to 1925, based on the growth from 1900 to 1915.

Mr. Wood: Mr. Kruttschnitt, if the Commissioners will bear with me a moment, I think, in view of the fact that by oversight there is but one copy of that chart, it would probably be well if you will read it into the record so that those who are here can catch the general significance of it.

Mr. Kruttschnitt: Chart No. 5 shows the growth of capital securities annually from 1900 to 1915. It has averaged about $630,000,000 a year, or a total of nine thousand six hundred millions for the period. Using the figures preceding 1915 as a guide, we have projected forward on the chart to 1925 the estimated capital requirements for that period. They aggregate six thousand four

CHART NO. 5.


ALL RAILWAYS OF UNITED STATES
ESTIMATED GROWTH OF CAPITAL SECURITIES, 1916 TO 1925, BASED ON RATE OF GROWTH DURING PERIOD 1900 TO 1915
Billions Dollars
1900 1901 1902 1903 1904 1905 1906 1907 1908 1909 1910 1911 1912 1913 1914 1915 1916 1917 1918 1919 1920 1921 1922 1923 1924 1925
35 34 33 32 31 30 29 28 27 26 25 24 23 22 21 20 19 18 17 16 15 14 13 12 11 10 9 8 7 6 5 4 3 2 1 0
Actual Increase 1900–1915 $9,600,000,000
Estimated Increase 1915–1925 $6,400,000,000
Note:
Estimated annual incr. of capital, 1916-1925, incl. $640,000,000
Average annual capital requirements for refunding funded debt matured from 1916 to 1925 165,000,000
Total annual capital requirements $805,000,000

hundred millions. Of course it would be at the same rate as the preceding capital expenditures of six hundred and thirty millions, approximately, per annum.

There is no question that capital expenditures for much needed second tracks, yards and terminals and motive power have been deferred on many lines during the last few years, because of financial difficulties, and, latterly, because of the high prices of materials and equipment. This accounts in part for the congestion in the last two years. It is perfectly obvious, however, that such expenditures cannot longer be deferred, although prices instead of falling have still further advanced in face of a fall in the average ton-mile rate in 1916 to substantially seven mills. There has been no time in recent years when the credit of the world has been so strained as it is today, and the ability of the railroad companies to procure capital for necessary improvements with which to meet the growing demands of commercial and government transportation, should be strengthened and not impaired.

I.—Emergency.

(*a*) In view of these conditions, the necessity of an immediate increase in the revenue of the carriers to meet the actual increases in expenses with which they are already confronted, to maintain their credit, enable them to provide increased motive power, cars, terminals and other facilities to accommodate the commercial business of the country, and to increase the efficiency of transportation to adequately serve the United States Government in war conditions, creates an

emergency which calls for prompt and serious consideration. The fundamental causes requiring relief for Southern Pacific lines are the same as those affecting other lines. All carriers are subject to similar increases in cost of labor, material and supplies. It may be said that all lines are not affected to the same degree or that each does not require exactly the same relief when measured only by their relative net incomes, but the practical reasons why equal relief should be granted to each are:

(1) Because it is impossible to afford the relief that is indispensable to one or more lines in a given territory without at the same time increasing the rates of a more prosperous line in the same territory.

(2) Because it is desirable, if not absolutely essential, to avoid prejudice or discrimination to competing sources of supply, one of which may be served by more prosperous lines than those that serve the other.

(3) Because the general conditions, both with respect to the future volume of traffic and the increase of expenses, must be the same upon all lines regardless of the different degrees in which increases in expenses or fluctuations in revenue may have been manifested up to this time; that is to say, the same general influence will operate upon all of the carriers throughout the country.

(4) A horizontal percentage increase is the fairest method of distributing the increased cost of transportation between commodities and between localities and, subject to the prompt restoration of prescribed or recognized differential relations between markets, will best preserve the interests of all shippers and communities. In addition to this important consideration, it would have been impracticable to compile the form of supplement which has been authorized by the Commission to permit the prompt filing and early use of the advanced rates by any other method than a horizontal percentage increase.

(5) While the estimated increase in wages and other expenses for the calendar year 1917 represent varying percentages of the gross freight revenue upon different groups of lines, these estimated increases upon a group of twenty different lines in western classification territory represent 13.98 per cent. of their gross freight revenue for the calendar year 1916. A horizontal increase of fifteen per cent. will be insufficient, on the whole, to meet the increased cost of operation, as it is estimated that after the necessary readjustments of rates shall have been made, the amount realized will not exceed 12 per cent. of the gross freight revenue for the year 1916.

(*b*) An enormous increase in the cost of fuel, equipment, material and supplies, the present and prospective increases of taxes, and the increased wages to other classes of labor, following the Adamson law, are supplementary to the steadily increasing cost of operation of recent years, to

our state of war and to the Adamson act in creating the existing emergency.

Our state of war requires ample resources to maintain and operate the properties with such efficiency as to meet the requirements of the United States Government, no matter how suddenly or extensively they may develop. This is not confined to movement of what is commonly known as government business but affects all of the factors which enter into the industrial mobilization. The capacity of the carriers limits the ability of industries of the country to furnish what is required by the United States Government and its allies.

The measure of relief directly necessitated by the Adamson act is specifically shown by the statistics which have been submitted by the carriers—the increase in wages on the Southern Pacific lines on this account for the calendar year 1917 over 1916 being computed as..... $ 1,601,400

Other wage increases granted or agreed upon will amount to an additional	3,658,367
Increased cost of fuel	1,181,254
Increased cost of material other than fuel	7,902,883
Increase in taxes	859,309
	$15,203,213

The above estimates do not include the extremely heavy increases in taxes which are now contemplated by Congress and do not include any anticipated increases in other expenses likely to become effective during the present calendar year

such as increases in other classes of labor than those directly affected by the Adamson Law, nor increased cost of fuel produced by subsidiary companies.

The carriers as a whole cannot wait to meet these conditions until their proposed advances are subjected to the usual period of suspension. The expenses and demands of the war are here and the revenue to meet them must be provided without delay, which we believe to fully warrant the Interstate Commerce Commission in cutting all red tape and permitting the effectiveness of the advanced rates not later than July first, if the carriers are expected to efficiently perform the services which will be required.

(*c*) Increases in wages and taxes and in the cost of fuel, material, and equipment, and everything purchased by the carriers, as well as the expensive requirements of federal and state laws, such as the full-crew laws, hours of service law, safety appliance acts, locomotive inspection and headlight statutes, began long before January 1, 1917, but culminated in an emergency for the carriers as a whole since the first of January, when they were obliged to pay the wages fixed by the Adamson law and other increases in wages influenced by it, and additional increases in costs of fuel and material when new purchases became necessary. That the emergency is not reflected in the operations of the Southern Pacific lines prior either to January first or April first, 1917, is due to the following:

(1) An unusual increase in their gross revenues during the past year in consequence

of the volume of traffic temporarily diverted to them by the curtailment of service through the Panama Canal and in the demand for such commodities as the products of mines and agriculture which was stimulated by the European war.

(2) The increase in railway operating income of the Southern Pacific Company for the first quarter of 1917, amounting to $4,045,000, due to abnormal conditions in no wise typical of what the operations will be for the entire calendar year 1917. In the first quarter of 1916 the passenger revenues of the Southern Pacific Company were subnormal as compared with the passenger expenses, due to sharp falling off in passenger traffic immediately after the close of the California expositions. This result was to be expected, but it was impossible to curtail the passenger train service to offset the fall in revenue. Comparing the first quarters 1917 and 1916, our passenger train mileage and, inferentially, passenger train expenses were not increased; therefore, the passenger revenue of 1917, which had again returned to normal and exceeded that of 1916 by $2,172,000 could be considered all net, and this extraordinary condition, which was confined largely to the first quarter of the year, accounts for 54 per cent. of the increase in railway operating income.

(3) The remaining increase in railway operating income is explained by the fact that maintenance expenses had not yet responded to the increase in traffic and were affected but slightly by the higher prices of material which

will apply later in the year. A large and quick increase in traffic can be handled for some time with existing facilities and without immediately increasing maintenance expenses, but with lapse of time experience shows that these expenses rise with, but not as quickly as, revenue.

(4) It is the custom of the Southern Pacific Company, because of its distance from eastern markets, to carry comparatively large stocks of material, its requirements in this respect being naturally greater than that of railways adjacent to such markets, which can obtain supplies currently without delay. We carried over into 1917 from the previous year over $16,000,000 worth of materials, purchased, of course, at prices prevailing before that time, which were much below prices in the early part of 1917, and far below present ones. These stocks represented a consumption of from three to four months. From this it is apparent that the operations for the first quarter of 1917 showed comparatively little effect of the present high material prices. As last year's stocks are consumed, our operations will be profoundly affected and our results for the first quarter of 1917 are not an index of those of future quarters.

(5) Unlike maintenance, our transportation expenses showed for the first quarter of the year an increase of 34.5 per cent. compared with an increase of but 10 per cent. in train mileage and 27.7 per cent. in operating revenue. Normally, the rise in maintenance expenses follows transportation expenses fair-

ly closely, and, but for conditions mentioned affecting maintenance, there is no question that operations for the first quarter of the year would have resulted very differently. Even as it is, our operating ratio, including taxes, was 72.44 per cent. compared with 68.18 per cent. for calendar year 1916.

To test the disappearance of the emergency will be as easy as to prove its existence. The carriers have already agreed to show, whenever called upon by the Commission, whether the trend of rising prices has been permanently arrested, and if so, to what extent, if any, the cost of operation is lowered, just as they now show the abnormal expenses to which they are immediately subject.

II.—War Conditions.

The recent action of the carriers in creating a special committee on national defense contemplates the subordination of railway traffic and facilities of all roads to the preferred needs of the government. The commission on car service has directed that gondola and hopper cars shall, when made empty, be returned promptly to the home road which, as to the Southern Pacific, means a considerable sacrifice as it can make but limited use of these cars under the restrictions imposed.

The demands for food products of all kinds and the demands for shipment abroad will tax the resources of all carriers to satisfactorily comply with them and they are so urgent that they must be complied with promptly regardless of expense.

Taking passenger cars out of regular service for the transportation of troops must necessarily

interfere with the ordinary passenger transportation. Travel will be curtailed and freight handled at full commercial rates will have to give way to government business handled at less than commercial rates and under conditions which will involve increased cost. No estimate can be made of the volume of government traffic that the carriers will be called upon to move, but to whatever extent it displaces commercial business, both gross revenue and operating expenses will be adversely affected. The movement of troops usually involves a one-way haul of empty equipment, and it is estimated that both troops and freight of the United States Government are handled over lines in western classification territory at an average of about 33⅓ per cent. less than the rates applicable to commercial business—all lines equalizing the rate applicable by the lowest land-grant route. The Southern Pacific lines face a still more serious situation on their free line between Portland, Oregon, and Roseville, California, government business between Portland and San Francisco, for example, being handled at 86 per cent. less than the rates applicable on commercial business. Hence, the gross revenue upon government business will be materially less than on same volume of commercial business.

III.—Labor and Wages.

(*a*) The total amount of increase of wages during the period from January 1 to March 31, 1917, upon the Southern Pacific Lines, resulting from advances in wage rates which became effective since December 31, 1916, is $1,182,300.

(*b*) All of this amount has been included in the

report of operating expenses made to the Interstate Commerce Commission covering the three months from January 1 to March 31, 1917, but if wages which have become effective since March 31 were applied to the months of January, February and March, there would be added $303,556 to the foregoing figures.

(*c*) Of the foregoing advance, $409,000 is directly attributable to the Adamson Law.

(*d*) The total increase during period January 1 to March 31, 1917, which resulted from advances in wages effective since December 31, 1916, is 2.7% of the total operating revenue of the Southern Pacific lines for the three months specified; is 4% of the total operating expenses as reported; and is 7% of the net operating revenue as reported for the three months specified, being 4% of the freight revenue.

Neither the foregoing figures nor those covering the Southern Pacific lines which are embraced in the composite tables of lines in western classification territory, include any increases in wages except those which have already been made effective, and will certainly be supplemented by increases to satisfy demands of other classes of labor which are estimated may amount to about $5,000,000 per annum.

IV.—Cost of Fuel, Material and Supplies.

(*a*) Current fuel contracts and costs are substantially higher than those in effect a year ago. No changes have been made in divisions of freight rates affecting proportion accruing to the Southern Pacific Lines as purchasers since December

31, 1916. The average price of fuel oil per barrel prevailing in 1916 was, on our Pacific system, 75.6 cents, while this year oil is purchased at rate of $1.20 per barrel. On our lines in Texas and Louisiana, last year's contracts averaged 66.9 cents per barrel, this year's 87.3 cents. Coal purchased for steamships for our Atlantic coastwise service cost last year $3.27 per ton, this year $5.15 per ton.

(*b*) Whilst the increase in the price of rails will not affect operating expenses for the calendar year 1917, the contracts which we have let for delivery next year show an increase in price from $30 to $35 per ton, and prices now current for future delivery are at the rate of $40 per ton.

That means that we have, in our contracts, contracted for a supply for two years at the price of rails before the first advance was made. There is no increase in cost on that account.

The cost of ties has materially advanced, average prices of 1916 being $7 per thousand feet, compared with $9 per thousand feet—an increase of 29%. Prices of all other classes of railway material and supplies have increased in very much greater ratio, particularly in the case of metals. For example, steel castings now being purchased cost 100% more per pound than those purchased last year; pig iron increased 158%; malleable castings increased 101%; rivets increased 140%. These advances over 1916 are on prices effective last year, which were much higher than those applying to earlier periods. Comparing 1917 prices with those current in 1915 and 1914, there have been general increases of from 125% to 350%, and without exaggeration it may be stated that the average of these prices is at least double

COMPARATIVE PRICES OF COMMODITIES PURCHASED BY SOUTHERN PACIFIC COMPANY.

JULY 1, 1914—100.

Commodity.	May 1, 1917	May 1, 1916	July 1, 1915	July 1, 1914
Steel Castings, per lb.	145.67	133.33	100.00	100.00
Portland Cement, per bbl.	128.57	110.71	100.00	100.00
Annealed Fence, per 100 lb.	244.80	176.00	104.00	100.00
Bar Iron, per 100 lb.	364.08	252.43	116.50	100.00
Atl. S. S. Coal, per ton	163.49	103.81	98.41	100.00
Bridge Stringer I-Beams, per lb.	259.46	181.08	102.70	100.00
Illuminating Oil, per gal.	160.00	123.64	95.45	100.00
Linseed Oil, per gal.	233.01	139.32	104.85	100.00
Cast Iron Pipe, per net ton	304.11	167.12	93.15	100.00
Stationery	225.00	125.00	100.00	100.00
Babbitt Metal, per 100 lb.	318.81	234.66	231.61	100.00
Fabricated Deck Plate Girders, per lb.	259.46	181.08	102.70	100.00
Malleable Castings, per lb.	178.57	88.69	98.21	100.00
Brass Journal Bearings, per lb.	215.31	198.91	108.87	100.00
Steel Boiler Tubes, 2" tubes, per ft.	244.12	188.24	91.18	100.00
Rivets, per 100 lb.	375.00	156.25	100.00	100.00
Tie Plates, Flat Bottom, per ton	229.01	190.84	91.60	100.00
Cotton Waste, per lb.	163.00	135.00	90.00	100.00

those in effect two or three years ago. (See statement attached hereunder.)

The Chairman: If it is convenient at this stage, will you explain that increase in the fuel oil, in cost? Does the Southern Pacific own the oil fields itself?

Mr. Kruttschnitt: It does; but I mentioned specifically that in the estimates of increased costs of oil supply, the oil supplied by our subsidiaries is not included. We include increase in cost only of oil purchased.

The Chairman: What proportion would the oil purchased be of the total oil used as fuel by the Southen Pacific, generally speaking?

Mr. Kruttschnitt: I cannot answer that offhand, but I should say, roughly, perhaps we purchase 25 per cent. to 30 per cent. of our oil.

The Chairman: As to that which is produced by the company, is there a noticeable increase in the cost of production?

Mr. Kruttschnitt: I have not in mind the cost of production, but I can answer with great confidence that there is an increase of cost of everything involved in the production; that is, tubes for the oil wells, well casing, labor, all have gone up.

The Chairman: But would that be represented by cents per barrel?

Mr. Kruttschnitt: It is, and we can give it to you.

Heavy decapod locomotives contracted for 1917 delivery will cost us about $45,000 each, and it has been closely estimated that the same equipment if purchased a year earlier would have cost only $32,000, and if purchased two years earlier only

$24,600. The present price for these locomotives is $51,000.

That is the price recently paid by a connection and given me by an officer of that connection, who purchased locomotives subsequently, the same as ours, but about two or three months after we purchased, and in that period the price had risen from $45,000, which we paid, to $51,000, which he paid.

Switch locomotives recently purchased have cost exactly twice as much as similar locomotives purchased in 1913 and 1914. Oil tank cars recently contracted for cost $2,900 each, compared with $1,466 paid for similar cars last year—an increase of nearly 100% in price. Gondola cars under contract will cost $1,900, the same cars built two or three years ago costing about $1,000. Passenger car prices show similar ratio of increase. The actual cost of equipment to be delivered in the first quarter of 1917, which is now under contract, will be $3,774,000; it would have cost $2,337,000 in 1916, and only $2,063,000 a year earlier.

Early in 1916 we placed orders for a number of automobile cars at a price of $1,351; inquiries to determine the cost of building the same cars in 1917 show that this price would be increased 74%, making it $2,350 apiece.

V.—Recent Changes in Rates.

(*a*) and (*b*) Statistics have not yet been compiled to show effect of increases or reductions of rates and changes effective since January 1, 1917, on the Southern Pacific lines but will be prepared and filed with the Commission.

(*c*) and (*d*) Southern Pacific lines are not interested in southeastern lumber rates, and there

have been no substantial increases in lumber rates in the southwest in which the Southern Pacific lines participate since January 1, 1913.

(*e*) For the 15 months from January 1, 1916, to March 31, 1917, the increase in operating income amounted to $12,524,554.83. A large part of the surplus earnings have been used in making necessary additions and betterments during the period mentioned; the remainder will be used during the year 1917 for the purchase of equipment, steamships, construction of new office building (San Francisco), advance for new constructions (San Diego & Arizona Railway), and for sundry additions and betterments, all of which have been authorized and contracted for.

VI and VII.—The Reasonableness of the Proposed Increased Rates, and Application to be Made of Proposed Increased Revenue.

Aside from the rates made to meet water competition, which are less than reasonable, the interstate rate structure of the country consists mainly of rates which have been found by the Interstate Commerce Commission to be reasonable under the operating conditions existing at the time they were made. The price of everything else has been substantially increased. The value of transportation must be measured by a new standard, and we contend that the proposed rates will not be more than reasonable. The return to Southern Pacific lines on investment in road and equipment during the fiscal year ended June 30, 1916, was but 4.98% on an investment of $939,971,000, and during the calendar year ended December 31, 1916, was but 5.39% upon an investment of $951,831,000. If the

full increase of 15% in freight revenues could be realized—and we know that it cannot—there would be but a slight increase in net income, which would probably be consumed before the close of the year by expected items of increase which have not yet become effective.

Our plea for a 15% increase in freight rates is predicated entirely upon an estimated increase in expenses which will substantially consume all the increased gross revenue. The idea of basing an increased dividend rate on the increased earnings accruing from the higher rates, if granted, certainly never occurred to any of our officers or directors. The Southern Pacific Company has a very conservative dividend policy, to which it has long adhered, and it has invariably reinvested immediately any surplus over dividend requirements in its properties. I do not think there is even a remote probability of a departure from this policy.

I would say that the fifteen per cent. applied arbitrarily to the gross freight earnings for the calendar year 1916 would produce an increase of $16,869,000, and the list of estimated increases in expenses that we have submitted amounts to $15,203,000. In other words, the increase, if allowed, and if all could be realized, would produce an increase in revenue of $1,665,000.

Mr. Donnelly: That will be all.

Commissioner Meyer: Mr. Kruttschnitt, aside from such government transportation as you may perform over the Mount Shasta route, do you regard it probable that the transportation of supplies for the government and troops will constitute an appreciable financial burden to your company?

Mr. Kruttschnitt: For government supplies, yes.

Commissioner Meyer: Taking your company as a whole, and aside from what may be moved over the route from Roseville to Portland.

Mr. Kruttschnitt: Perhaps I can answer that best by telling you that in the little excitement and scurry on account of the condition of affairs in Mexico, our lines were called on to perform very large services for the government—services aggregating payments of considerably over $2,000,000. I happen to remember that because the government is very, very much in arrears in paying us. Up to two months ago they had not paid us at all. This $2,000,000 was hung up in the air, and was owed us, but not in the treasury. Now, just that little scurry in Mexico required us to perform services that aggregated about $2,000,000. If we get into—well, we *are* in a real war now, and it is conceivable that the requirements of the government will be very heavy.

Commissioner Meyer: Do you regard that service as having been unprofitable to your company?

Mr. Kruttschnitt: The service to the border?

Commissioner Meyer: Yes, sir.

Mr. Kruttschnitt: I really could not tell you about that. Of course, I am told by our traffic people that this government service is conducted generally at a rate of about thirty-three per cent. below the commercial rate.

Commissioner Meyer: Do you know how they arrive at that thirty-three per cent.?

Mr. Kruttschnitt: No, I have not the figures in mind so that I could state them. Of course, the earnings of railroads, however they accrue and at whatever rate they are produced, are handi-

capped in that it meant a haul of all of that equipment empty one way, and on the mere question of collecting our earnings we shall lose anywhere from $75,000 to $125,000 in interest.

Now, I am only giving you roughly the reasons why I say, in answer to your questions, that I do not know, I really could not tell you, how profitable that business was without making an analysis of it, which I have not done up to the present time.

Commissioner Meyer: You speak of the hauling of equipment empty, which is, of course, an item of expense; but assuming that the cost of hauling troop trains is double the hauling of the ordinary passenger train, do you think even so that business would be unprofitable?

Mr. Kruttschnitt: No. The troop trains are generally fairly well loaded, and, offhand, answering your question as best I can without preparation or much thought, I should say that I think that that business would be profitable.

Commissioner Meyer: Based upon some 37,000 train miles the average actually earned was somewhat in excess of $6. Do you think that would apply to your company?

Mr. Kruttschnitt: To answer that, Mr. Commissioner, I would have to guess at four or five factors, and I am afraid my answer would not be worth much; I do not know that we received $6 per mile but unquestionably passenger traffic that paid $6 a mile, I should say, was very desirable and very profitable—

Commissioner Meyer (interposing): As a matter of fact, of course, those earnings would be accompanied, as you have said, by a corresponding larger outgo because of the empty hauling.

Mr. Kruttschnitt: Another item of expense which would affect the situation, which I have not yet mentioned, was an expense of from $60,000 to $75,000 for temporary facilities for the government, temporary sidings both at entraining and detraining points.

Commissioner Meyer: Having made some calculation as to the check of these figures, Mr. Kruttschnitt, my information is, that taking deductions on account of land grant hauls of all kinds, including such deductions as would accrue on your Mount Shasta route, the entire deductions amount to about 18 per cent. Now, that could be checked. We are simply trying to get at the increased burden, if there is any, that the war may cast upon the carriers.

Mr. Kruttschnitt: Yes. Of course, on the Shasta line—I do not know whether I made it clear or not in my statement—we get absolutely nothing for the carriage from Portland to Roseville.

Commissioner Meyer: I understand that.

Mr. Kruttschnitt: Which is substantially six-sevenths, of the distance. That is why the revenue accruing from Roseville to San Francisco makes the reduction from the tariff rates 86 per cent., as I recollect now.

Commissioner Meyer: If Commissioner Clements were here this morning I am sure he would want to ask you what possible economies might have been worked out to meet the requirements of the Adamson Act by relocation of your division points and changing the runs, and so forth. The Commission would be interested in knowing your judgment on that point.

Mr. Kruttschnitt: We have had actual experience with the Adamson Act since the first of Janu-

ary, that is, in a very definite direction, in paying the men the increased wages. When the Act went into effect I wrote a general letter to our three presidents calling their attention to the very large increases this Act would bring about in the wages of the class of employees involved, and urged them to study every possible measure of economy to offset those increases. It is too early yet to know just what they have done. My letter was acknowledged, and I was assured that the studies would be made. But I am sufficiently familiar with operating conditions on our line to say that as to the remedies suggested by this Adamson Act, as I gather from press reports and as I gathered from him personally at the time that I appeared before his Committee, his suggestion that we change all division terminals is not practicable. There are three serious objections to that. First and most potent of all is the very large expenditure of capital it would take to readjust and rebuild all of these division points. With us and with a number of roads in the West the location of division points has been determined by the possibility of getting water. We have gone over that entire Western country, I might say, from San Antonio to the California valleys, and from Ogden, Utah, to the Sierra Nevadas—we have gone over it repeatedly with examinations by geologists and water experts, and if we were to give up the present division terminals I do not know where on earth we would get water for our locomotives.

The only economy that could be effected by changing the location of all division points would be possible economies in overtime or in the ability to get services for all the time that we

have to pay for under the Adamson Law. Now, against trying to get full value received for what we pay for we have to look to what the interest charges on this new capital would cost us, and whatever can be done is a question for the future to determine. We cannot tell what we can do until we have operated under this law quite awhile, until all of the officers of the company shall have studied the conditions. I am quite certain on our line we shall not be able to accomplish very much. To effect these economies, as Mr. Adamson suggested when I appeared before him, was a very simple matter to him. All we had to do was to speed up our locomotives from 10 miles an hour to 12½ miles an hour. I told him that to accomplish a schedule of 10 miles an hour over a road a train has to run from 50 per cent. to 100 per cent. faster than the schedule. To make 10 miles, including all of the stops for water, traffic and unforeseen delays, requires a speed of actually from 15 to 18 miles an hour; and to make 12½ miles would require a speed of from 20 to 22 or 23 miles an hour. I explained to him that we had never yet found a method of coaxing a locomotive to haul as much freight at 20 miles an hour as she hauled at 15. He said it was because we had not tried hard enough. I told him we should try harder in the future, but that I doubted very much whether we would be successful.

Mr. Wood: To speed up your trains you would have to reduce the train tonnage, which would increase the train mileage, and thereby increase, in very large measure, the number of men in the

train service, and you would have to pay all of those men these additional wages?

Mr. Kruttschnitt: Certainly. The net result would be, a larger number of trains, each hauling a less number of tons.

Mr. Wood: In connection with the possible redistribution of terminal points, even if such a redistribution were feasible, would there not be increased operating expenses due to increased yard service, and possibly other increased operating expenses, that would follow the enlargement of the number of terminals?

Mr. Kruttschnitt: Anything that increases the number of trains naturally increases the service for switch engines. As I say, I cannot now do anything but outline the difficulties ahead of us in complying with the Adamson Law, and our efforts to minimize the expenses it will involve. I do not think any of us could give any intelligent estimate until the law has been in practical operation for perhaps six months or a year.

Commissioner McChord: Most of the carriers that have produced testimony here have indicated that the increase of 15 per cent. would not result in meeting the increased costs, increased prices of material; that there seems to be a deficit in their ability to meet their obligations for material and supplies. Now I was wondering what is going to happen with respect to the needed increased motive power and cars if, under the old prices, the carriers were not able to supply themselves with adequate motive power and cars—that is, what would be done if the increase in freight rates would still fail to meet the bill?

Mr. Kruttschnitt: That simply continues them

in the position and conditions in which they were before. They would have to continue to do what they did before.

Commissioner McChord: With the same facilities?

Mr. Kruttschnitt: On the same facilities, buying whatever they can out of surplus, and from borrowed moneys.

Commissioner McChord: You know we had a pretty hard time last winter with respect to cars and motive power, and I was just forecasting the future.

Mr. Kruttschnitt: Those troubles of last year were not altogether due to shortages in equipment. The troubles of the winter were unusual and were very much intensified by extraordinary movements of freight from the West.

Commissioner McChord: You know we had those troubles beginning in September and October and November—they were very, very, very keen—shortage of cars.

Mr. Kruttschnitt: Well, the carriers have transported anywhere from 30 per cent. to 50 per cent. or 60 per cent. more tonnage last year than they did in previous years—but they did not do well enough to prevent all hardship and complaint, and that is very regretable. What they did do I think was very commendable.

Commissioner McChord: I think so.

Mr. Kruttschnitt: They did buy equipment; that is, they increased their capacity, but they could not buy enough to meet the demands made upon them.

Commissioner McChord: Yes, I agree with you.

Mr. Kruttschnitt: Take in our case, for instance. We have had embargoes on certain freight via our Atlantic steamship line almost continuously for about two years. When the freight began to move more rapidly than we could transport it we went into the open market for charters, and we made charters in some cases paying all for the use of an outside ship that we obtained as earnings. In other words, the freight was carried on the ocean simply out of a sense of duty to our patrons. We got nothing for it at all. We chartered forty or forty-five ships as long as ships could be chartered, and when they were diverted to the trans-Atlantic and other business, or to traffic from Galveston to New York, and we were left with our own ships only, we had to put on embargo after embargo, because the ships could not carry the freight, and I might say that when we did charter ships to bring freight to New York quicker than we ever had done, it simply resulted in freight being packed sometimes ten or twelve feet high on the piers, because of the inability of the New York people to take it.

Commissioner McChord: I just had in mind that many of the roads need more motive power, and many of them need more cars, and many of them need additional terminals.

Mr. Kruttschnitt: That is quite true.

Commissioner McChord: And my thought was where are they going to get the money to do that?

Mr. Kruttschnitt: I do not know where they can, unless they get it out of their business or by borrowing it. And borrowing is a very sorry way to get it under the rates that are paid at present. We have, as I have said, always applied our surplus to those purchases, as far as it would go.

In our equipment purchases for the past three years, excepting some that we shall build in our shops, and excepting some locomotives that we expect to pay for out of cash on hand, we have resorted to equipment trust certificates, paying about five and a half to five and three-quarters per cent., but with the returns on property that I have read off here, none of which is as high as five and a half or five and three-quarters per cent., there is an actual drain on the resources of the company in borrowing the money at five and three-quarters per cent. when they can only get from four per cent. to four and three-quarters per cent. out of that money when invested in its business.

Commissioner McChord: Borrowing money in the market is, of course, a pretty expensive business at the prevailing rates of interest. I have seen it suggested—I am not advocating the theory—that it might be well for the government to arrange the purchase of bonds of the railroad companies at a low rate of interest, and not leaving them at the mercy of the money market.

Mr. Kruttschnitt: To purchase railroad bonds at low rates of interest?

Commissioner McChord: Yes.

Mr. Kruttschnitt: About 1912, the French Government issued 300,000,000 francs face value of 4% bonds, to realize an equivalent amount to be loaned to railroads. The standard Government bond in France, known as "rentes," of which 22,000,000,000 face value in francs are outstanding, fell immediately to 92.6, and in about a year fell to 83,

the depreciation forced on the "3% rentes" being *greater than the 300,000,000 francs raised* on the new loan.

Commissioner McChord (interposing): The matter that I suggested was not issuing bonds as securities for the purchase of the railroads, but simply purchasing, as was necessary, the bonds of the railroads. For instance, if the Southern Pacific needed $100,000,000 to buy equipment and it could only get it in the market at an exorbitant rate of interest, the government would purchase those bonds instead of the railroad going out into the money market; take their entire holding, but not anything tending in the direction of government ownership.

Mr. Kruttschnitt: If the Government purchased bonds of Southern Pacific and other railroads, it would be obliged to sell its own bonds to raise the money to turn over to the railroads. For many years past the railroads have been spending $650,000,000 per annum in improvements. In face of the Government's large war bond sales it could not sell $650,000,000 per annum on a 3½% basis. A much higher interest rate than that of the war bonds would have to be paid, and the experience of the French Government would be repeated—that is, the market price of war bonds would fall so that the return on them would approximate the return on the bonds sold to relieve the railroads. I doubt whether the Government could borrow such large sums as the railroads would need at much if any less rate than could the railroads, with good credit.

Commissioner McChord: Then you think if they started to take them it would ultimately result in the government having to take them all?

Mr. Kruttschnitt: No, I do not say that. I say it would pull down the value of other securities. It would work two ways. It might help the railroads, but it would affect the prices of other government securities.

The Chairman: Mr. Kruttschnitt, do you consider that you have had adequate power on the Southern Pacific for the business that you have to transact?

Mr. Kruttschnitt: I do not. We have managed to handle the business without serious trouble, but for the last two years requisitions have been presented for more locomotives and more cars and more improvements—all of which were considered vital by someone, but when they were assembled in some one central office the amount of money that was necessary was simply paralyzing; it could not be gotten, and our wants had to be reduced to meet our ability to pay for them either in cash or, as I say, in securities. After two years campaign trying to get money we did resort to securities to pay for some equipment. This year, following a very good year in 1916, we hope to pay for the new equipment under contract with accumulated surplus.

The Chairman: You could use to advantage more locomotives and more cars?

Mr. Kruttschnitt: Very many.

The Chairman: Have you had any policy of annually increasing your equipment; that is to say, annual additions to your cars and locomotives?

Mr. Kruttschnitt: Yes. That policy is determined in this way. We take the business conducted during the preceding year and determine

about how many transportation units we turned out for each locomotive and car, estimating what the increase would be for the next year, and predicating the requisitions for motive power on those figures.

The Chairman: You are not moving back in that position as to locomotives or cars through anticipation that when the boats are returned to the Panama Canal route the volume of your tonnage will fall off in such a way as to leave you with a surplus of rolling stock?

Mr. Kruttschnitt: I confess as to that we are very much at sea. We do not know what to do. For years preceding the completion of the Panama Canal the question of what we should do when the canal was opened was a subject of perhaps monthly conferences among the officers of the company. We needed additional ships. We had once a requisition for freight ships prepared, and were on the point of placing the contract when a doubt was raised as to whether our Sunset Line would have freight enough for the ships when the Canal was opened. We deferred placing the contracts for those ships, thinking that our present fleet would handle everything that we would be called on to handle. After the Canal was opened we thought that our judgment was correct; that we had sufficient ship capacity to handle all of the traffic of the rail lines terminating at New Orleans and Galveston. Shortly after the Canal was opened the slides came. That meant large temporary shipments of freight over our line, and that embarrassed us both as to locomotives and as to steamships. Then the Canal was reopened and the freight went back to it. Then we prepared and presented to the Commission a plan that we had in

contemplation before the Canal opened to be allowed to compete for some of the freight the Canal had taken from us by putting in very much lower rates than had prevailed theretofore, predicated on the freight being handled in abnormally large carloads at moderate speed, which meant large trainloads. Permission was granted, and we got back some of the freight that the ships took from us. By the time those methods were working fairly satisfactory came on the war and the ships were taken away from the Canal. Then there was a sudden rush to the rail lines again to ship over the Sunset Line, and it overtaxed our facilities that we had not increased because we expected this freight to stay permanently on the Canal, and we were also without the six ships that we once thought of buying to help out the shippers. However, when we found what the needs of the railroad lines were after the Canal was opened and we had felt its full influence, we did place contracts for two large freight ships to be delivered in August or September.

The Chairman: Do you regard the terminals of the Southern Pacific as adequate?

Mr. Kruttschnitt: In some places, yes; in others, no.

The Chairman: In order to meet the volume of traffic that you face at the present time, will there be required a considerable expenditure around the terminals?

Mr. Kruttschnitt: A very large expenditure. As I say, when the requisitions came in for the last two years they called for such extremely large sums of money that the great majority of them simply had to be deferred, put in a pigeon hole for consideration at some other time. In other

words, we had to do as an individual does, get along with what we had.

The Chairman: In estimating what a fifteen per cent. increase would give you based on last year's business if you can get the whole of the fifteen per cent., did you include the business in Texas, into Texas and out of Texas?

Mr. Kruttschnitt: Everything.

The Chairman: Affected by the so-called Shreveport case?

Mr. Kruttschnitt: We applied fifteen per cent. to a hundred and twelve million dollars, which was the amount of the freight earnings of the entire Southern Pacific System for the previous year. Fifteen per cent. on a hundred and twelve million dollars is sixteen million and eight or nine hundred thousand dollars. But adjustments of rates as between localities, I am told by our traffic officers, will cut that down. That is a theoretical amount which we never can obtain. We do not know how much we shall be able to retain out of the fifteen per cent., if it is granted, but certainly not all of it.

Commissioner Harlan: You estimated that at twelve per cent., did you not?

Mr. Kruttschnitt: That is a rough estimate which will be replaced by an estimate which I understand our traffic officers have already promised the Commission to make and file hereafter.

Commissioner Harlan: Did that twelve per cent. assume an increase in your freight rates of fifteen per cent?

Mr. Kruttschnitt: We took our entire freight earnings and applied the fifteen per cent. to them. It also assumed a condition, which, I suppose, will be very hard to bring about—it assumed

that in all of the states the state commissions would grant increases on state traffic, because the state traffic contributes in making up this total of a hundred and twelve million.

Commissioner McChord: Do you know the volume of the intrastate and the interstate?

Mr. Kruttschnitt: Yes.

Commissioner McChord: Have you separated it?

Mr. Kruttschnitt: Not in computing the effect of the fifteen per cent., no, sir.

Commissioner McChord: That is what I had in mind.

Mr. Kruttschnitt: We applied it to everything under the heading of freight earnings for 1916.

Commissioner McChord: I was wondering what it would amount to simply on the interstate?

Mr. Kruttschnitt: I could not tell you that.

Mr. Wood: Our comptroller states, Mr. Commissioner, about forty per cent. of the earnings accruing to us are from state traffic, and sixty per cent. from interstate. We would be glad to file a statement in detail.

Mr. Kruttschnitt: So that if we get the entire fifteen per cent. on the sixty per cent. it would be only nine per cent., and that would be still further reduced by the necessity of adjusting rates so as to keep them in proper relationship, and that would mean a considerable reduction of the nine per cent.

The Chairman: The Commission understands that the percentage supplement is not to be attached to the Shreveport tariff, so-called, that is, the tariff that has been put in by the Texas lines following the decision of the Commission in the

Shreveport case, so that there are other instances in which this supplement could not be used.

Mr. Kruttschnitt: On account of litigation in Texas we have not counted on any action by that state. We think possibly that other states than Texas would agree to these increases.

The Chairman: I am not referring now to the state rates but to the interstate rates affected by that Shreveport decision.

Mr. Kruttschnitt: I would like to ask our traffic director that question.

Mr. L. J. Spence: The rates from Shreveport and from Ruston, prescribed by the Commission, to Texas, are not included.

The Chairman: Now, you spoke of buying a part of your fuel oil supply. Is that by contract, and if by contract, for what period of time?

Mr. Kruttschnitt: Some of it is bought on period contracts and others in flat lots. In other words, we go in the open market, and after testing it, pay for a million or two million barrels at the market rates.

The Chairman: And what course is pursued by your company in respect to coal?

Mr. Kruttschnitt: The same.

The Chairman: Partly by contracts and partly—

Mr. Kruttschnitt: No, with coal—I will take that back. All of our coal purchases are on contracts let on competitive bids.

The Chairman: And the contracts run for a period of a year or some other period?

Mr. Kruttschnitt: I do not think we have any running more than a year.

The Chairman: Have such contracts recently been made?

Mr. Kruttschnitt: The most recent one is the

one I have alluded to in my statement, the contract for a quarter million tons of coal delivered in the bunkers of our Atlantic steamships at New York. I think the old contract expired the first of March, or the first of April. The contractor offered to renew the contract, as I remember it, at about $5 a ton. When presented to me, I told our manager that I thought that we should take competitive bids, and we lost about three weeks in trying to get competitive bids. I think we got two bids. There were three old contractors who declined to bid for the business, and in that three weeks time the price had arisen so that the contract was finally let at $5.15.

The Chairman: Does your system own or operate any coal mines?

Mr. Kruttschnitt: No.

The Chairman: Would you file with the Commission what you consider as representative contracts of last year and for this year with respect to fuel coal and fuel oil?

Mr. Kruttschnitt: Yes, sir.

Commissioner Harlan: What is the current dividend paid by the Southern Pacific Company?

Mr. Kruttschnitt: Six per cent.

Commissioner Harlan: What is the rate of interest on the outstanding bonds?

Mr. Kruttschnitt: I think four to seven per cent.

Commissioner Harlan: What percentage would the interest paid and the dividends paid amount to on the whole capitalization?

Mr. Kruttschnitt: The dividends amount to about sixteen and a half million dollars or 6% on capital stock and the fixed charges a little over twenty-four millions, about an average rate of 4.4% on all funded debt outstanding.

Commissioner Harlan: And do you know what the surplus was—what was the amount of your surplus in the last two years?

Mr. Kruttschnitt: The last two years? In fiscal year ended June 30th, 1915, we earned just a little over our dividend. It was 7.2 per cent. In 1916 it was 10.98 per cent. on the outstanding stock. Now when we changed to the calendar year, 1915, we earned ten per cent.; for the calendar year 1916, 12.3 per cent.

Commissioner Daniels: If you should obtain the fifteen per cent. and should incur the increased expenditure that you calculate, would the two not very nearly offset each other, so far as you can now forecast?

Mr. Kruttschnitt: They would.

Commissioner Daniels: And that would leave your net income from operation practically at the level of the last calendar year if the two just offset each other?

Mr. Kruttschnitt: Yes, if our estimate of expenses, as I have taken care to point out, are confined to expenses actually incurred on the wages actually granted, and they do not exceed that. But there are a number of items which we did not think we could say certainly what they were, and we did not want to affect the accuracy of the estimates that we submitted, and so did not put them in those estimates. We know that we have a lot of grievances now. We have a threatened strike of telegraphers on the system in Louisiana and Texas, they demanding large increases in wages. We shall certainly have to pay something, and the wages of those men will be increased also a number of others. For instance, within the last few weeks ferry hands in San

Francisco not only demanded the Adamson Law, but something more. They not only wanted the terms of the Adamson Law, but said they would have to be given a day a week, that is a seventh of their time, off. They were finally settled with substantially on the terms of the Adamson Law, dropping the extra day. That added a hundred thousand dollars to our pay roll. Almost contemporaneously with that freight handlers at San Jose and San Francisco and Los Angeles made demands, and settlement was made with them, and it cost, as I remember it now, about $60,000 a year.

There are grievances from all parts of the line, from other classes of employees, who want these raises. Now, none of those items that I have just mentioned are in this statement. I just received a notice from the government engineer in charge of the Oakland Harbor for a new drawbridge over the harbor. That bridge is sufficient for all the needs of navigation, but the people of Oakland want an ornamental bridge and a larger one, so that they may have more room, and we have got an order to replace that bridge. It will cost us five or six hundred thousand dollars.

If we should be granted the fifteen per cent. increase and should collect it all and turn it into the treasury it will, as I said, but little more than cover the increased expenses actually incurred, the difference being between, about fifteen and a half millions and sixteen million eight hundred thousand, or something like that.

Commissioner Daniels: But excluding these possible expenditures that you may be called upon to meet, those listed and mentioned would just about equal the possible maximum increase in revenue, so that you would break even on that basis?

Mr. Kruttschnitt: Yes, sir.

Commissioner Daniels: And that would leave, would it not, the net operating income of the last calendar year, or the last fiscal year, for the current year and for the future years just on the same basis?

Mr. Kruttschnitt: Yes, for the present volume of traffic.

Commissioner Daniels: And that net operating income for the last fiscal year is the maximum, or is considerably above the average, is it not, for the last eight or ten years for the Southern Pacific System?

Mr. Kruttschnitt: 1916 was an unusually good year, and above the average.

Commissioner Daniels: So that—does it not come to this, that the essential reason urged by your company is that the previous net operating income has not been an adequate compensation for the investment that you have made and not being made by other carriers, that without the increases they will actually have their net operating income of the past year seriously crippled or diminished? There is that essential and substantial difference, is there not, in the position of your company in contrast with that of other carriers?

Mr. Kruttschnitt: That I think is true, that the expenses of the Eastern carriers have grown and increased more rapidly in proportion to their increased earnings than ours have; in other words, they have been unable to hold in their treasuries the same percentage of their gross increases that we have.

Commissioner Daniels: I just wanted to bring out the contrast in that respect.

Commissioner Harlan: I would like to ask, Mr. Kruttschnitt, whether there is any agreement among financial men connected with the railways as to the amount of percentage that should be carried to surplus each year in order to leave a safe margin for credit purposes?

Mr. Kruttschnitt: There is a general formula used by financial men and railroad operating men, that for every dollar paid in dividends there should be a dollar of surplus put into the property.

Commissioner Harlan: In the case of the Southern Pacific you ought to carry six per cent., then—

Mr. Kruttschnitt: Substantially, yes.

Commissioner Harlan: —on the amount of your stock for surplus?

Mr. Donnelly: That is all, Mr. Kruttschnitt.

Mr. Thorne: Will the witness furnish a statement of the securities that he has sold during the last ten years and the rate that he has sold them at? He has described certain inability to get money at reasonable rates. The Western carriers, in the Western case, gave that specific information at our request.

Mr. Chairman: Mr. Kruttschnitt, that can be furnished, can it not?

Mr. Kruttschnitt: A list of the securities sold and the amounts realized on them or, rather, the rate of money? Is that what the gentleman wants?

The Chairman: For a period of what?

Mr. Thorne: Ten years.

Mr. Wood: That will be furnished.

The Chairman: And you offer as exhibits these tables?

Mr. Wood: Yes; and there are two statements as well.

(The tables and statements referred to were thereupon received in evidence, marked "Exhibit No. 1, Witness Kruttschnitt," "Exhibit No. 2, Witness Kruttschnitt." "Exhibit No. 3, Witness Kruttschnitt," "Exhibit No. 4, Witness Kruttschnitt," "Exhibit No. 5, Witness Kruttschnitt," "Exhibit No. 6, Witness Kruttschnitt," "Exhibit No. 7, Witness Kruttschnitt," "Exhibit No. 8, Witness Kruttschnitt," "Exhibit No. 9, Witness Kruttschnitt," and are filed herewith.)

Mr. Thorne: Mr. Kruttschnitt, in your Exhibit 6, you refer to increase in mileage of railroads. Does that refer to single track mileage or all tracks? For instance, if you added a switch or double track would that be included there, or would it be under the single track?

Mr. Kruttschnitt: It is miles of railway, not miles of track.

Mr. Thorne: That would be all tracks, then, single or double?

Mr. Kruttschnitt: Take the Interstate Commerce Commission statistics, they give the mileage of railroads built, and they give another column giving the mileage of second, third and fourth tracks, and another column giving the miles of yards and sidings. This includes simply the miles of line.

(Witness excused.)

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